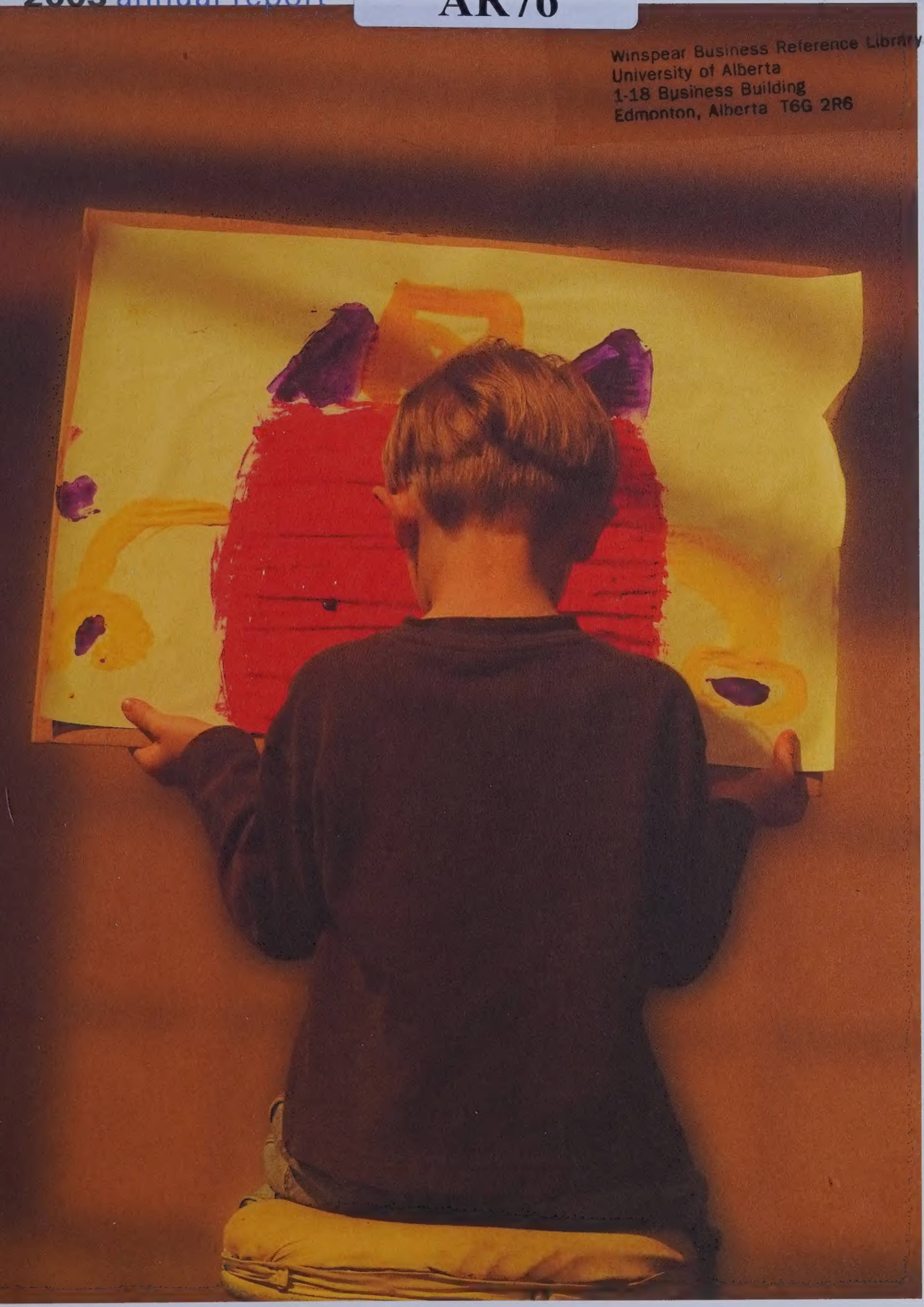
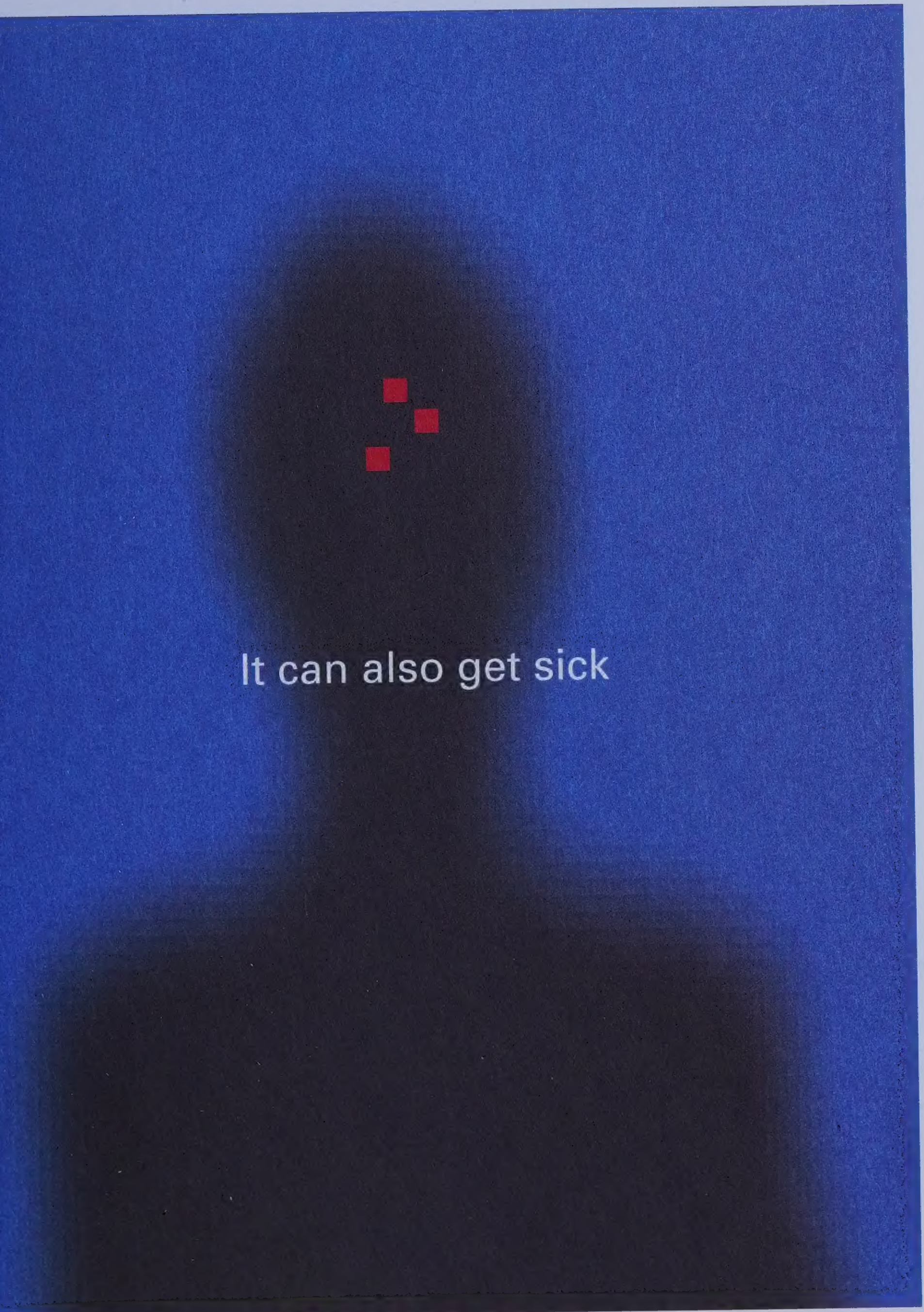
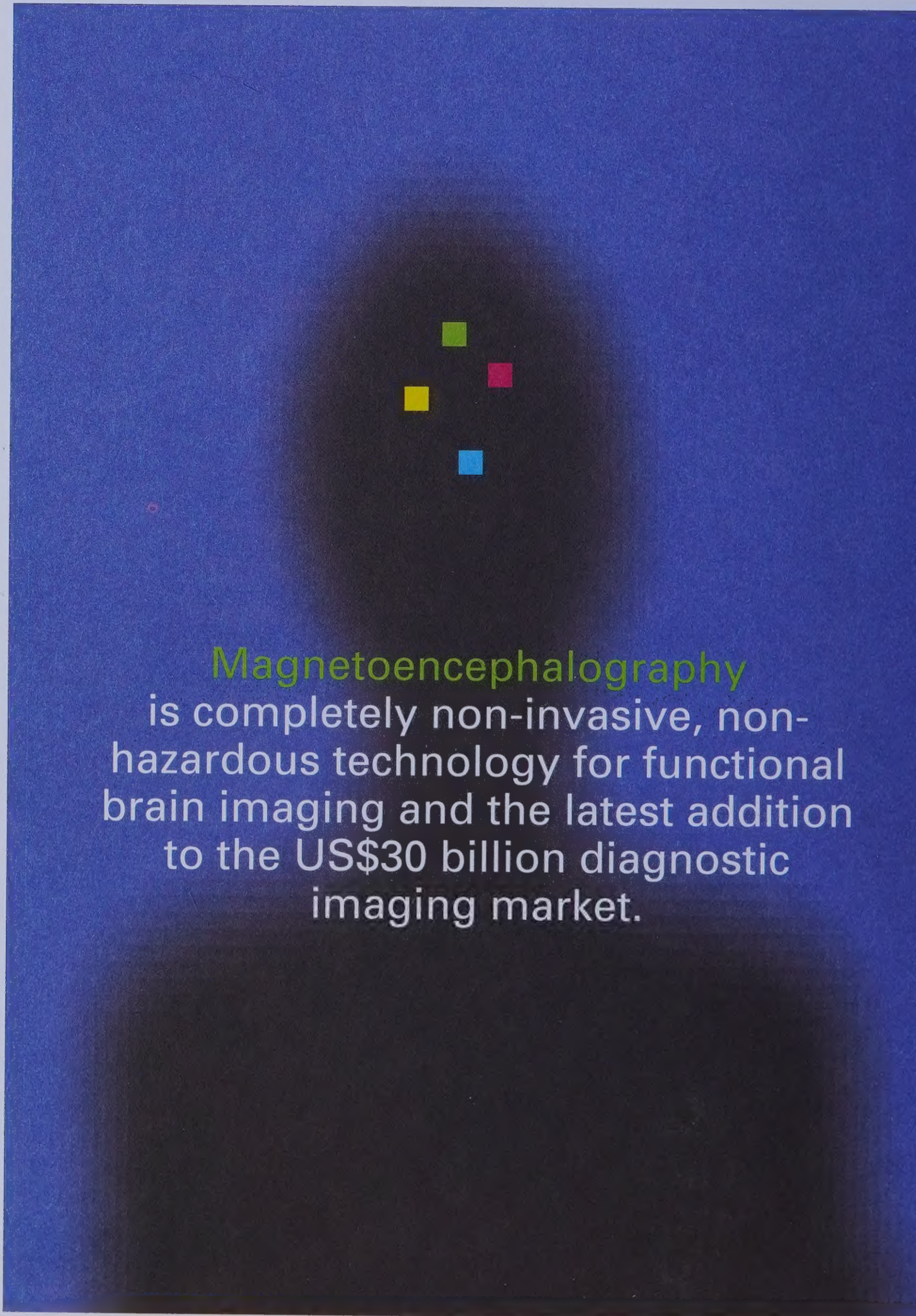
2003 annual report

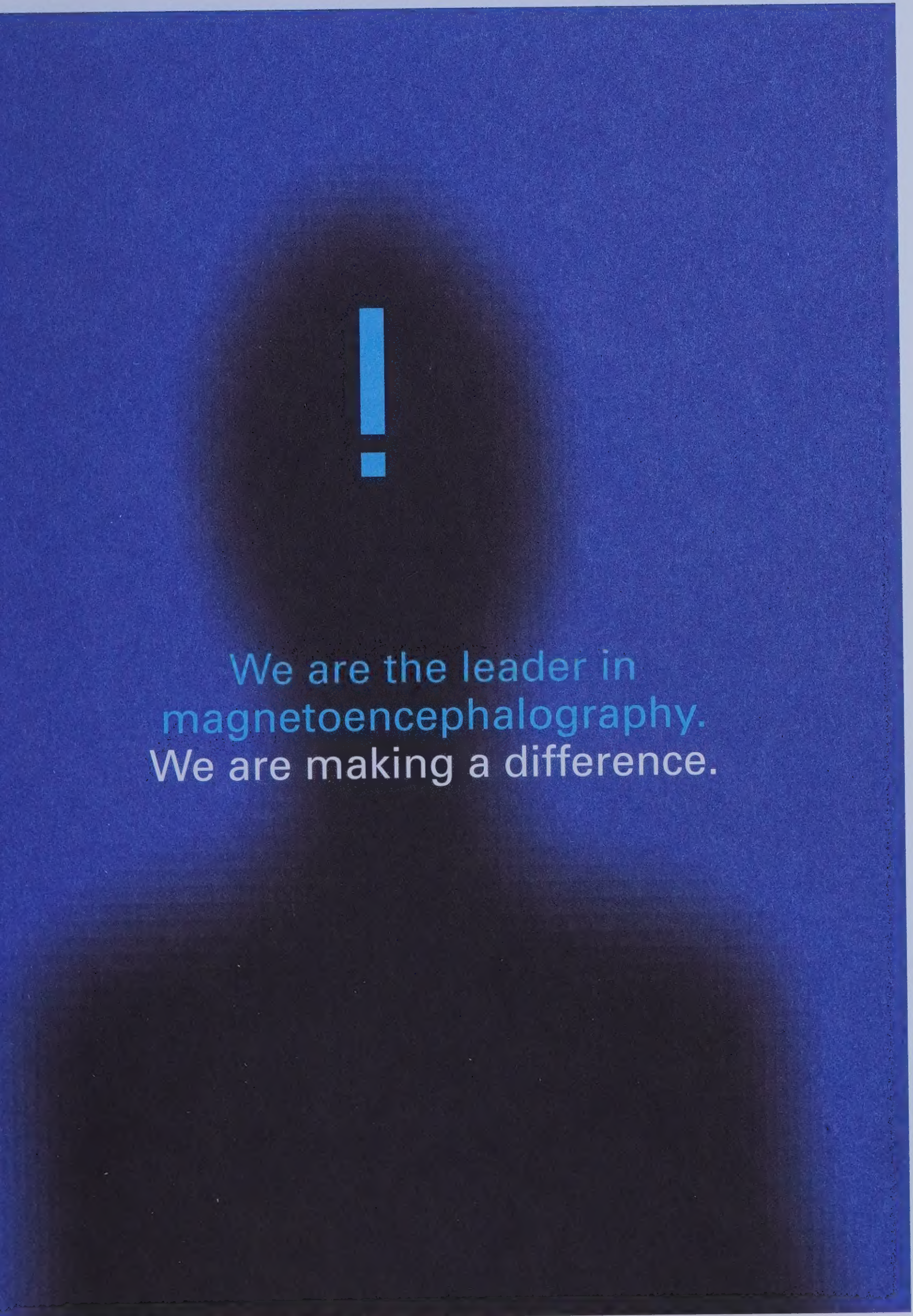


VSM MedTech Ltd.

The brain is the most powerful computer in the world. It can memorize millions of words, invent games, develop relationships, understand the Big Bang or create art...


It can also get sick


Magnetoencephalography
is completely non-invasive, non-hazardous technology for functional brain imaging and the latest addition to the US$30 billion diagnostic imaging market.

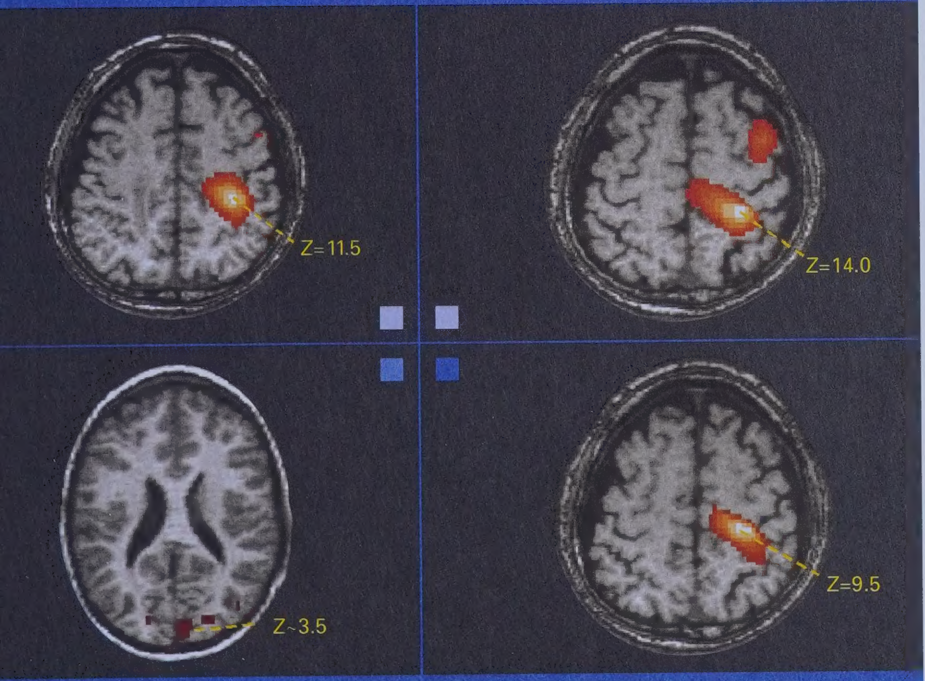

!
We are the leader in magnetoencephalography.
We are making a difference.

A New Paradigm in Imaging Technology

Magnetoencephalography (MEG) is a revolutionary medical imaging technology that provides unprecedented insight into the workings of the human brain by measuring its electromagnetic activity (electrophysiology). In measuring the magnetic fields created by the electric current flowing within the neurons, MEG identifies brain activity associated with various human functions – in real time, with spatial accuracy to within two millimeters. As such, MEG provides clinicians with invaluable additional information in planning their surgical treatments, showing great promise that it can contribute to better patient outcomes. For researchers, MEG is an equally powerful tool in the ongoing quest to discover how the human brain operates, especially as it relates to diseases and disorders. A passive and non-invasive technology that neither emits strong magnetic fields nor requires injection of radioisotopes, MEG recordings are safer, less traumatic and less expensive than intracranial electroencephalographic (EEG) procedures. Importantly, MEG complements other ubiquitous neuroimaging modalities such as magnetic resonance imaging (MRI), providing clinicians and researchers with even greater functionality and more powerful information.

MEG can reliably detect even subtle changes in brain function, such as those corresponding to the presence and absence of migraine headaches. The orange spots show locations of brain activity, and their amplitude is indicative of the migraine severity.

- *MEG indication of migraine with increasing severity (first row).*
- *Immediately following treatment with drugs, MEG shows that the migraine is relieved.*
- *One day following treatment, MEG indicates that the migraine has returned (rebound migraine).*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The Technology Leader in MEG

VSM's magnetoencephalography system is the most technologically advanced MEG instrument available in the world today, offering up to 275 MEG sensors and up to 128 simultaneous EEG sensors to ensure optimal MEG recordings. The exquisite sensitivity of the MEG sensors is achieved by utilizing the world's most sensitive detector of magnetic fields based on quantum mechanical principles. In addition, the Company's systems use an optimized MEG sensor design and patented method of noise cancellation to ensure accuracy of measurement in challenging environments with significant background interference created by strong magnetic signals such as electrical lines and moving magnetic objects.

VSM's proprietary Synthetic Aperture Magnetometry (SAM) software is a new MEG imaging technique that uses spatial filtering to significantly enhance the signal-to-noise ratio of signals from the investigated brain regions while attenuating signals from other regions of the brain, other biological sources such as the heartbeat and eye-blinks, and environmental noise. SAM is based on well-established beam-steering techniques adapted from radio astronomy.

A Steadily Developing Global Market

CPT Codes Facilitate Continued Penetration of the U.S. Clinical Market

In the bottom-line minded U.S. hospital market where return on investment (ROI) plays an important role in the decision to purchase capital equipment, approval for reimbursement of procedure fees by third party payors (including both public and private insurers) is of critical importance. In January 2002, the U.S. Centers for Medicare and Medicaid Services critically reviewed Current Procedural Terminology (CPT) codes for a range of MEG procedures, including the localization of epileptic foci and pre-surgical functional mapping, and increased reimbursement for these procedures. These rates have steadily increased since then, most recently in January 2004. To further strengthen the clinical business case for MEG, VSM is continually working with researchers and clinicians to pursue increases in rates and coordinate research into procedures for which reimbursement is not yet being sought by clinicians.

The University of California at San Francisco and Kansas University Medical Center are two customers that have purchased VSM MEG systems in the context of developing a successful clinical MEG practice. These hospitals join several other institutions that are currently benefiting from increased reimbursement rates for epileptic foci localization and pre-surgical functional mapping in accordance with CPT codes for these procedures.

Epilepsy as a Market Driver

Currently, the most common application of magnetoencephalography is to aid in the diagnosis of epilepsy. This use demonstrates the significant market potential of MEG. With more than five documented cases of epilepsy per 1000 people in the United States and 43 million cases worldwide, there exists a significant market opportunity for a passive, non-invasive imaging technology that can aid in the treatment of this disease.

Epilepsy is a debilitating disease that is especially prevalent among children and the elderly. In 20% of cases, epilepsy can only be cured surgically by removing a small part of the brain that causes epileptic seizures. The major challenge, however, lies in pinpointing the exact origin of the epileptic activity and removing only that part of the brain that is causing symptoms. The current "gold standard" for localization, intracranial EEG recording, involves a highly invasive surgical procedure whereby a sensor grid is placed directly on the patient's brain and connects to a portable EEG that the patient must wear in the Intensive Care Unit for as long as two weeks. Not only is this procedure extremely traumatic for the patient, it poses its own potential health risks and can even be fatal.

As a non-invasive, passive technology, MEG has the potential to achieve comparable or even improved patient outcomes non-surgically – in just a few hours, at a lower cost, and, most importantly, with less trauma and lower risk to the patient. MEG can not only provide more precise information – 2 to 3 millimetre accuracy versus 7 to 8 millimetres using the intracranial EEG method – it is more efficient and can detect smaller zones of epileptic activity.

VSM's MEG system is currently being used for epilepsy localization at a number of clinical sites worldwide, including the prestigious Hospital for Sick Children in Toronto and the National Institutes of Health in Bethesda, Maryland.


"I can help"
Dr. Otsubo


"Using VSM's MEG technology,
I now have a passive, non-invasive instrument that
complements and, in some cases, enhances the
diagnostic approach to localizing epileptic foci.
The greater temporal and spatial resolution of MEG has
the potential to increase the standard of care
for our patients."

Strengthened Sales Strategy

VSM's magnetoencephalography sales efforts focus on the North American, European and Asian markets – the largest markets for imaging technology. VSM entered 2004 with a revitalized global sales strategy designed to ensure that the key components required to drive sales of an emerging imaging technology are in place. The direct sales strategy focuses on maximizing the short term potential of the research market and accelerating the development of the clinical market.

One of the keys to success in developing and growing the market for an emerging medical technology is generating broad awareness of the existence and benefits of that technology. Accordingly, VSM has initiated a program to inform and educate those in the medical community about the capabilities of MEG for both clinical and research applications. The program will focus specifically on referring physicians and end users such as neurologists and neurosurgeons. As part of this initiative, VSM's sales team will contact every major hospital, research center and medical university, not only about the merits of the Company's own MEG system but also about the medical and economic benefits of MEG in general.

In North America, the foundation of this strategy is a new distribution network with the capability to proactively promote the benefits of both magnetoencephalography in general and VSM's MEG system to potential customers. The network is structured to not only address the key geographical markets within the U.S. but also the most important clinical institutions, including epilepsy centers, neurological sites and teaching hospitals.

While VSM expects to derive the majority of its long-term MEG system revenues from the clinical market, the research market will play an important role in MEG sales over the short term. VSM's MEG systems are currently being used by leading academic and other research centers around the world for investigation into a wide variety of neurological diseases and disorders. In addition to providing an important short-term revenue stream, MEG devices sold for research purposes contribute significantly to building awareness and a future pipeline of clinical applications.

Customer Services Unit: Building Long-Term Relationships

Since its acquisition of CTF Systems, VSM has established itself as both the technological and customer service leader in the magnetoencephalography space. Technological leadership alone is insufficient to grow market share in a highly competitive environment, and VSM has a proud tradition of providing superior customer service. As part of our ongoing commitment to excellence in the support of its customers and products, the Company established a dedicated Customer Services business unit in January 2004. Leading medical device providers around the world employ a similar model, using focused customer service business units to build and maintain strong, long-term client relationships. Dedicated resources will allow VSM to provide highly responsive service, and the Company will work closely with customers to address and meet their evolving needs through the provision of a growing array of innovative, value-added services.

The new business unit provides a range of services including preventative maintenance, repair and customer training to the Company's existing MEG installed base. Early stage growth in this business unit will come from the introduction of an expanded range of technical and value-added services that will help customers maximize their investment in the technology. The new business unit is expected to generate a recurring stream of higher margin revenue, contributing approximately $1 million to the top line in 2004.

endless opportunity

Driving Short- and Long-Term Value

VSM's magnetoencephalography (MEG) system for functional neuroimaging will be the primary growth driver for the Company over both the short and long terms. The market for MEG is expected to continue to steadily develop as:

- General awareness among the medical community of the applications and benefits of MEG broadens;
- Reimbursement of fees by third party payors expands to new applications and increases for existing applications; and
- Key decision makers recognize the economic benefits of clinical use.

With leading technology and exemplary customer service and support in a market with limited competition and high barriers to entry, VSM is well positioned to capitalize on this significant opportunity.

MEG and Other Applications

In addition to the diagnosis of epilepsy, MEG is currently approved and used for mapping the functions of the brain prior to neurosurgery. For intracranial procedures, it is critical that areas of the brain responsible for key functions such as sight, hearing and motor skills are not damaged. MEG allows surgeons to accurately identify the location of such functions to ensure that these areas emerge from surgical procedures untouched. In the U.S. alone, there are more than 220,000 intracranial procedures annually, the majority of which could benefit from pre-surgical functional mapping using MEG.

Magnetoencephalography is also used in research applications, including the study of neurological diseases and psychological disorders. MEG is currently being investigated for use in the diagnosis, assessment and treatment of:

- Alzheimer's disease;
- Parkinson's disease;
- Mental disorders (e.g. schizophrenia, depression, dementia);
- Multiple sclerosis;
- Migraine headache and chronic pain;
- Cognitive disorders (e.g. autism, learning disorders, Down's Syndrome); and
- Stroke.

Worldwide Incidences of Diseases and Disorders of the Brain

BpTRU is offering both primary care and hospital physicians alike an accurate, automated option to measuring blood pressure with traditional manual mercury and aneroid sphygmomanometers.

evolving

BpTRU™: Capitalizing on Expansion

Since its commercialization, VSM's BpTRU has offered both primary care and hospital physicians alike an accurate, automated option to measuring blood pressure with traditional manual mercury and aneroid sphygmomanometers. Designed to eliminate the drawbacks associated with auscultation, including inter-reading variability and situational ("white coat") hypertension, BpTRU offers a superior level of accuracy, convenience and value. The Company's first product, the BpTRU Model BPM-100, first hit the market in 2000. Subsequently, the Company introduced the Model BPM-200, which incorporated battery powered portability and USB connectivity. With the receipt of FDA clearance from the US Food and Drug Administration during the year, the Company introduced the BpTRU Model BPM-300, which incorporates a temperature probe along with all the features of the BPM-200.

Along with recent appointments to the sales team, the evolving strategy for the BpTRU product line calls for simultaneous targeting of several key markets. The Company will continue to pursue OEM and private label agreements, similar to the partnership with [illegible], which allows corporate customers to incorporate BpTRU technology into their product lineup. VSM will also maintain and expand regional distributor relationships that target the primary care environment (doctors' offices). Finally, VSM is introducing a focused direct sales force that will both work closely with distributor sales reps in the primary care environment as well as independently in the hospital market, identifying "points of entry" including for cardiology, hypertension and diabetes wards. During 2003, the Company announced that Biovail Corporation will use the BpTRU in its Tiazac® evaluation study, and VSM expects that sales to pharmaceutical companies that incorporate BpTRU products into their clinical trials will be an ongoing market opportunity. These expanded marketing strategies, in combination with established distributor relationships, will drive increased sales volumes in 2004 and beyond.

chairman's message

In 2003, primarily driven by demand for our proprietary magnetoencephalography technology, VSM began preparing to take the next step in its evolution from a small technology company to a growing commercial enterprise. To support our growth, we upgraded our infrastructure to accommodate anticipated increased business volumes and focused on extending our technological leadership in our respective fields.

In reviewing our progress of the last few years, we also undertook a complete examination of the Company's operations and practices. Based on this critical review, the Board identified areas where changes, based on our current stage of development, were required and began implementing measures that would improve financial reporting and business planning. These actions included the adoption of a new accounting policy that better reflects the standardization of our MEG products and the evolution of the MEG business.

Significant efforts were also devoted to planning for the future. Late in 2003 the Board appointed Jack Price, who had joined the Board of Directors during the third quarter, as its new Chief Executive Officer. We believe Jack's wealth of international business experience and his reputation within the medical technology community will be a valuable asset as we take VSM to the next stage in its evolution. We also added Ross Smith, FCA to the Board. Mr. Smith brings more than 40 years of accounting, finance, M&A and multinational expertise to the team. These changes, coupled with the earlier appointment of Chief Financial Officer, Rod Campbell, who brings extensive public company experience to VSM, significantly adds to the organization's bench strength.

On behalf of the entire Board of Directors I would like to thank Barry Allen, VSM's former President and CEO, for his work with the Company through its development stage and his efforts in supporting the transition to the new management team.

With the changes implemented through the early part of 2004, and with a stronger operating platform to conduct future business, we are certain that VSM is better positioned to realize the commercial potential of its leading-edge medical device technologies. I look forward to seeing VSM through this transition period as we complete our evolution from an emerging medical technology company into a rapidly growing enterprise offering a full range of products and services to a global customer base.

David Waterman
Chairman

message to shareholders

In the last six months, VSM MedTech has completed a series of initiatives designed to facilitate our ongoing evolution into a full service medical device company. These initiatives, reflecting our current state of development, included the adoption of a new revenue recognition policy, the appointment of a new Chief Financial Officer, senior sales appointments in both our functional brain imaging and vital signs monitoring businesses, the streamlining of our manufacturing group and the formation of a new customer services business unit. Our transition from a small research and development concern with a single product line into a medium-sized company offering a broad range of products and services has been ongoing since 2001. With many of the changes behind us, the Company is now better positioned to drive increased sales volumes across both its businesses, manage risk and take the next step in its growth.

Through the development of technologies like BpTRU™ and magnetoencephalography (MEG), VSM has assembled a strong portfolio of world-class medical device technologies. These fundamentals are unchanged and our industry leading technology base remains strong. The Company is now focused on the accelerated commercialization of our existing standard products while developing a pipeline of additional product opportunities. This strong foundation, coupled with the strategic initiatives we have undertaken, will help support stable, long-term growth.

Despite lower than expected order volumes, the MEG business continued to make progress in 2003. During the year we recognized revenue on five new sales, four to leading research facilities in both the United States and Europe and one to a commercial medical institution in China. VSM's MEG technology continues to gain prominence as an emerging and increasingly valuable imaging modality among global thought leaders. There are a number of factors that, in addition to increasing recognition, will drive clinical acceptance and growing sales in the future. Early in 2004, we appointed Brian Prejna as Vice President, North American MEG Sales. Mr. Prejna, most recently Manager of PET Sales and Marketing with General Electric Medical Systems, brings industry specific expertise and a track record of success to the organization. He and his team of seasoned sales professionals will play a significant role in improving MEG sales performance.

Critical early strategies to expand MEG's commercial potential include educating physicians, equipment buyers and healthcare organizations about the value of incorporating the technology in their patient care strategies. Elements of VSM's plans include sponsoring ongoing research designed to raise the visibility of the technology for both existing and future applications, pursuing additional reimbursement from third-party payors, and demonstrating the business case and revenue generating potential for the product. We continue to make progress on the reimbursement front as

the Centers for Medicare and Medicaid Services (CMS) recently approved a sizeable increase in payment rates for selected MEG procedures.

In terms of early clinical acceptance, China has taken a leading role in the adoption of MEG technology for commercial use. In 2003, VSM announced its third sale into China and shipped its first unit to that country. Chinese doctors have a tradition of treating epilepsy through surgical intervention, and the liberalization of the Chinese healthcare system has created increased physician demand for leading-edge technology. The Company continues to believe that China represents a significant market for its products. During 2003, we completed a distribution agreement with DCH Healthcare Products, supplementing the existing agreement with White Horse Medical. These agreements will further expand VSM's presence in the sizable Chinese market and ensure that the Company has the infrastructure to provide top-notch service to both new and existing customers.

VSM has always prided itself on providing not only leading-edge medical device solutions but also top quality service to its customers. In early 2004, in an effort to further enhance our service offering, we announced the formation of a dedicated Customer Services business unit. Many of the world's leading medical device providers operate using a proven model that incorporates a focused customer service business, which allows them to generate a recurring revenue stream. VSM will provide highly responsive service, working closely with customers, while proactively introducing new valued-added services that anticipate customers' evolving needs. To spearhead this new initiative we have appointed Paul Murdoch as Vice President, Customer Services. Paul has more than 20 years of experience in global customer service and was most recently Senior Vice President, Customer Services with Philips Medical Systems.

As with our MEG business, we strongly believe that VSM's BpTRU product line offers an unprecedented blend of technology and value. Subsequent to year-end, we took positive steps with respect to restructuring our BpTRU sales strategy and team to capitalize on the full potential of this product. With the appointment of Frank Iafrato, with more than 20 years of progressive corporate sales experience, primarily in healthcare and medical imaging, VSM significantly strengthened its sales team. The revised sales strategy for BpTRU calls for a multiple-pronged approach that will target several key markets simultaneously. VSM intends to combine expanded distributor relationships with a direct sales force to target the primary and secondary care markets. In an effort to drive volume increases, the Company will also continue to actively target OEM and private label opportunities in addition to sales to pharmaceutical companies for use in clinical trials.

Beyond our commercialized products, we possess a portfolio of developing products that includes both the Continuous Non-Invasive Blood Pressure (CNIBP) technology and a hybrid MEG/Magnetic Resonance Imaging (MRI) platform, which incorporates ultra low-field MRI technology developed

at the University of California's Lawrence Berkeley National Laboratory. The development of CNIBP is ongoing and we are working diligently to create a product that not only incorporates industry-leading technology and functionality but one that can be rapidly commercialized in conjunction with the right marketing partner. Hybrid MEG/MRI remains in the earliest stages of development and our focus in 2004 will be on completion of feasibility work, allowing us to develop a strategy to move ahead with formal product development.

Subsequent to year-end, we began moving into our new state-of-the-art 76,000 sq.ft. facility, which has integrated executive, research and development and manufacturing capabilities under a single roof. The move to new facilities will allow us to realize a number of operational efficiencies, while providing VSM with the infrastructure to support commercial scale manufacture of our leading edge medical device technologies.

In 2003 and into 2004 we invested significantly in both people and infrastructure, and it is this investment that will facilitate growth, moving us to the next level in the quarters ahead. The steps taken to date have significantly bolstered the Company and will allow us to align technological, human resource and operational strengths going forward. During the year we completed two financings raising total gross proceeds of $45.6 million, which provides us with the financial strength and flexibility to execute our growth strategy. In the year ahead, we intend to focus our energies on increasing sales of our commercialized products internationally, while simultaneously advancing the other products in our development pipeline toward market.

In closing, I would like to thank our employees for their hard work and dedication in 2003 and renewed commitment to excellence in 2004. I would like to thank our shareholders for their continued support of our vision to become a full-service medical device company and I look forward to updating you on our progress in the quarters ahead.

Jack Price
President and Chief Executive Officer

management's discussion and analysis of financial condition & results of operations

Certain statements in this report may constitute forward-looking statements that are subject to risks and uncertainties. A number of important factors could cause actual outcomes and results to differ materially from those expressed in these forward-looking statements. Consequently, readers should not place any undue reliance on such forward-looking statements. In addition, these forward-looking statements relate to the date on which they are made. See Notes to the Consolidated Financial Statements regarding commitments, contingencies, legal matters, environmental matters and other matters, which could materially affect the Company's future business, results of operations, financial position and liquidity.

Date: April 30, 2004

Overall performance:

The following discussion should be read in conjunction with the annual consolidated financial statements and footnotes. All financial information is prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and is expressed in Canadian dollars.

Selected annual information

(Tabular amounts in thousands of dollars, except per share amounts)

Years ended December 31,	2003	2002	2001
Revenue	**$ 11,378**	$ 14,203	$ 7,860
Net loss	**(10,363)**	(1,306)	(5,747)
Loss per share	**(0.28)**	(0.05)	(0.24)
Total assets	**53,053**	17,222	13,422
Long-term debt	**339**	–	–
Cash dividends per share	**–**	–	–

Results of operations

Year ended December 31, 2003 compared to the year ended December 31, 2002

Revenue

Revenue was $11.4 million for fiscal 2003, compared to $14.2 million for fiscal 2002, a decrease of 20%. The revenue decline was driven primarily by the adoption of product revenue recognition for standardized magnetoencephalography ("MEG") products in the fourth quarter of 2003 (see "Critical Accounting Policies and Estimates") and lower sales performance in the BpTRU blood pressure monitor division. Since a significant amount of the Company's revenues are earned in U.S. dollars, the decrease in revenue was also partially attributed to the weakening of the U.S. dollar throughout 2003.

Revenue from the MEG division was $10.8 million for fiscal 2003, compared to $12.8 million for fiscal 2002, a decrease of 16%. Several factors contributed to the decline in MEG revenue: Beginning in the fourth quarter of 2003, the Company adopted product revenue recognition for standardized MEG products, and consequently, revenue from two new MEG orders received during the fourth quarter will not be recorded until delivered and accepted by the customer; the Company discontinued revenue recognition on three MEG systems in progress (see "Loss on Contracts" below); and, the Company accepted certain amendments to a contracted MEG system that resulted in a reduction of revenue of $377,000.

Revenue from the BpTRU division was $605,000 for fiscal 2003, compared to $1.4 million for fiscal 2002, a decrease of 58%. Several factors contributed to the decrease in sales, including the focus by medical distributors on sales of SARS-related products, delayed marketing programs and the Company's strategic shift to an OEM/private label strategy.

Gross margin was $3.5 million (31%) for fiscal 2003, compared to $6.8 million (48%) for fiscal 2002. The decrease was the result of lower MEG and BpTRU sales, and a charge to cost of revenue relating to the write-down of approximately $600,000 in BpTRU inventory due to slower than expected sales activity. Although initiatives were taken to improve margins through early stage implementation of some lean manufacturing principles, investment in capital equipment to increase throughput, and by "batching" production of standardized components into more economic quantities, these improvements were not sufficient to offset the negative impact on gross margin of lower revenues against our fixed plant costs.

Expenses

Research and product development (R&D) expenses increased to $3.8 million for fiscal 2003, compared to $2.6 million for fiscal 2002. The increase is due to continued investment in R&D efforts directed at the Company's proprietary technologies in the MEG and blood pressure fields. Specific areas of increase occurred in headcount, salaries and research grants. In particular, a grant for approximately $460,000 was made to the University of California in San Francisco for the research of MEG applications. The Company also recorded approximately $210,000 in R&D for MEG inventory used specifically for research and product development purposes.

Sales and marketing expenses increased to $3.1 million for fiscal 2003, compared to $2.4 million for fiscal 2002. The increase in marketing expenditures is due largely to the Company's efforts to increase MEG product awareness in the U.S. marketplace. The Company had two senior sales staff in place for the full year of fiscal 2003 whereas in fiscal 2002 the first U.S. MEG sales staff was hired in the fourth quarter of 2002. Other costs such as tradeshows and travel also increased due to the focus on penetrating the U.S. MEG market.

General and administrative expenses increased to approximately $3.7 million for fiscal 2003, compared to $2.6 million for fiscal 2002. The primary areas of increase are corporate governance costs, additional headcount, salaries, legal and accounting fees, corporate communications costs, and insurance premiums.

Amortization expense increased to $606,000 for fiscal 2003, compared to $348,000 for fiscal 2002 as a result of amortization relating to equipment acquired in 2003.

Loss on Contracts

During the third quarter of 2003, the Company became concerned that certain customers would be unable to complete arrangements under contracted terms. As a result, VSM recorded a provision for a loss on the completion of two agreements. These agreements covered two whole-cortex MEG systems and one fetal MEG system. None of the systems had been shipped to the customers and, as such, none of the Company's inventory was considered at risk. Under one contract, the Company had recognized revenue and costs of sales on two MEG systems in the second quarter of 2003. The Company provided for a loss on the contract of $1.6 million. Under the second contract, the Company had commenced recognition of revenue and costs of sales on one fetal MEG system in the fourth quarter of 2002. The Company provided for a loss on the contract of $0.9 million. The current inventory, including all materials and labour, are for standard products and has been transferred and will be applied to sales to other purchasers.

Net Loss

The consolidated net loss for fiscal 2003 was $10.4 million ($0.28 per share), compared to a net loss of $1.3 million ($0.05 per share) for fiscal 2002.

Foreign Currency

A significant portion of the Company's revenue is received in U.S. dollars and a substantial portion of the Company's expenses is incurred in Canadian dollars. As a result, a change in the value of the Canadian dollar relative to the U.S. dollar will materially affect the Company's operating results. The Company generates the majority of its revenue under fixed price contracts, and during 2003 and 2002, recorded revenue on custom MEG systems based on the average rates experienced during the period of construction. At each balance sheet date the Company revalues accounts receivable denominated in U.S. funds to current rates. A currency translation gain or loss may be recognized.

Foreign currency translation gains and losses arising from normal business operations are credited to or charged to interest and financing costs in the period incurred. To date, the Company has not entered into any foreign exchange forward contracts. As a result, fluctuations in the value of the Canadian dollar relative to the U.S. dollar have caused and will continue to cause currency translation gains and losses. In times of a weakening Canadian dollar, the Company will recognize higher revenue and foreign exchange gains on transactions denominated in U.S. dollars. Conversely, lower revenue and exchange losses will be recorded when the Canadian dollar increases in value. During 2003, the strengthening Canadian dollar against the U.S. dollar reduced revenue by approximately $685,000 (calculated relative to the exchange rate in effect at December 31, 2002). During 2003, if the Canadian dollar were to have fluctuated in value by 10% against the U.S. dollar, revenue (based on 2003 product and currency mix) would have fluctuated by approximately $588,000.

Summary of Quarterly Results

(Tabular amounts in thousands of dollars, except per share amounts)

Quarters ended	2003							2002
	Dec	**Sept**	**June**	**March**	Dec	Sept	June	March
Revenue	**$ 660**	**$ 1,318**	**$ 5,294**	**$ 4,106**	$ 5,349	$ 3,049	$ 3,090	$ 2,717
Net (loss) income	**(5,857)**	**(5,156)**	**587**	**63**	446	(706)	(485)	(561)
(Loss) earnings per share	**(0.14)**	**(0.14)**	**0.02**	**0.00**	0.02	(0.02)	(0.02)	(0.02)
Diluted (loss) earnings per share	**(0.14)**	**(0.14)**	**0.02**	**0.00**	0.02	(0.02)	(0.02)	(0.02)
Total assets	**53,053**	**28,991**	**33,385**	**28,529**	17,222	16,355	20,197	13,685
Long-term debt	**339**	**565**	**497**	**–**	–	–	–	–

Liquidity and capital resources

Cash and cash equivalents totaled $30.0 million at December 31, 2003, compared to $1.8 million in 2002. Working capital was $40.0 million at December 31, 2003, compared with a working capital balance of $8.2 million in 2002. The increase in cash is due primarily to the completion of the Company's common share private placement and public offering that raised net proceeds of approximately $42.6 million, offset by cash used in operations of $13.4 million, and cash used to purchase plant and equipment of $2.2 million. The Company expects that the financial resources on hand are sufficient to continue operations and satisfy its obligations beyond fiscal 2004.

During the year, the Company expanded and extended its $2 million credit facility to a $6 million credit facility, composed of a $3 million line of credit and a $3 million term loan expiring in May 2006. At December 31, 2003, the Company had drawn $565,000 on its term loan for expenditures related to the purchase of equipment related to the Company's new SQUID (superconducting quantum interference device) manufacturing facility. As at December 31, 2003, the Company was in violation of a debt covenant relating to the achievement of a certain level of net earnings, which has subsequently been cured by way of a waiver received from the lender. It is expected that new covenants will be negotiated with the lender to reflect the Company's enhanced revenue recognition policy that came into effect in the fourth quarter of 2003.

Cash used by operations increased to $13.4 million for fiscal 2003, compared to $5.0 million in fiscal 2002. The continued use of cash by operations is due primarily to the higher balances of inventory, contracts in progress and operating expenditures for the year. The use of cash to fund inventory results from the Company's decision to build standard MEG systems and products to inventory. The use of cash to fund

contracts in progress relates to the Company's custom MEG system sales, and depends on the timing of progress payments received from the customers.

Investing activities used cash of $2.4 million for fiscal 2003, compared to a use of cash of $598,000 for the prior year. The increased use of cash for fiscal 2003 was due primarily to expenditures related to the purchase of equipment needed for the Company's new SQUID manufacturing facility, ongoing research activities and increased manufacturing levels.

On February 19, 2003, the Company completed an issuance of common shares by way of a private placement. The Company issued 5.8 million units at a price of $1.85 per unit for total gross proceeds of $10.7 million. Each unit consists of one common share and one-quarter of a common share purchase warrant. Each whole purchase warrant entitles the holder to acquire one common share, exercisable until the date that is two years from closing at a price of $2.00 per share.

On October 9, 2003, the Company completed an issuance of common shares by way of a public prospectus. The Company issued 4.7 million common shares at a price of $6.50 per common share for total gross proceeds of $30.5 million. On October 15, 2003, the agents exercised an over allotment option to purchase an additional 705,000 common shares at $6.50 per share for total gross proceeds of $4.6 million.

The Company's contractual obligations as at December 31, 2003 are outlined in the following table:

(Tabular amounts in thousands of dollars)

	Total	< 1 year	1 – 3 years	4-5 years	After 5 years
Long-term debt (1)	**$ 565**	$ 226	$ 339	$ –	$ –
Capital lease obligations (2)	**7**	7	–	–	–
Operating leases (3)	**9,036**	747	1,944	1,724	4,621
TOTAL CONTRACTUAL OBLIGATIONS	**9,608**	980	2,283	1,724	4,621

(1) Long-term debts relates to the Company's term loan (see "Liquidity and Capital Resources").

(2) Capital lease obligations are included in accounts payable and accrued liabilities on the balance sheet.

(3) Operating leases primarily relate to office furniture, computer and a long-term premise leases.

In the normal course of business, the Company enters into routine purchase commitments related to daily operations. In addition, the Company is in the process of purchasing and constructing equipment for a new SQUID manufacturing facility which is expected to be completed in the first half of 2004, with an expected cost of $4 million, of which $1.2 million had been incurred by December 31, 2003. The Company is also committed to make minimum payments under research collaboration agreements over the next four years aggregating approximately $788,000. In addition to the research collaboration agreements, the Company entered into an exclusive

license agreement for the use of technology necessary for the development of a hybrid MEG/MRI system. The agreement allows termination upon 90 days' written notice. Under the terms of the agreement, the Company has made an initial payment of U.S. $50,000 and is required to pay a royalty based on sales of the hybrid system. The agreement sets forth minimum annual royalties of U.S. $10,000 for the first two years and escalates to a royalty cap of U.S. $500,000 in 2009 and each year thereafter.

In 2004, the Company expects that capital expenditures be in the range of $6 million to $6.5 million as the Company consolidates its businesses into a new facility with increased manufacturing capacity. The Company expects to finance $3 million of its capital expenditures through currently available debt financing. The remainder of the source of funds for our future capital expenditures and commitments is expected to be cash on hand, accounts receivable, contracts in progress, cash from operations, debt financing and equity issues. The Company expects that the current cash on hand is sufficient to fund foreseeable operations. However, if continued losses are incurred well into the future, the Company may require additional capital to fund its ongoing research and development, product development, marketing and other operating activities, as well as capital expenditures.

Off balance sheet arrangements

The Company is not aware of any material off balance sheet arrangements requiring disclosure.

Transactions with related parties

In 2003, the Company paid fees for consulting services totaling $67,250 (2002 - $94,750) to a former director of the Company. In addition, prior to the negotiation of a final management employment contract, the Company paid fees of $108,333 to a director of the Company for consulting services. In 2002, the Company recorded interest income of $1,202 with respect to loans to directors repaid in 2002.

Fourth quarter

Three months ended December 31, 2003 compared to the three months ended December 31, 2002

Revenue

Revenue was $660,000 for the fourth quarter of 2003, compared to $5.3 million for the same period in 2002, a decrease of 88%. The revenue decline was driven primarily by the adoption of product revenue recognition for standardized magnetoencephalography products in the fourth quarter of 2003 (see "Critical Accounting Policies and Estimates") and lower sales performance in the BpTRU division.

Revenue from the MEG division was $600,000 for the fourth quarter of 2003, compared to $4.7 million for the same period in 2002, a decrease of 87%. The primary factor that contributed to the decline in MEG revenue was that at the beginning in the fourth quarter of 2003, the Company adopted product revenue recognition for

standardized MEG products. Consequently, revenue from two new MEG orders received during the fourth quarter has not been recorded under the percentage of completion method, but will be recorded when the systems are delivered and accepted by the customers.

Revenue from the BpTRU division was $60,000 for the fourth quarter of 2003, compared to $588,000 for the same period in 2002, a decrease of 90%. Several factors contributed to the decrease in sales, including delayed marketing programs and the Company's strategic shift to an OEM/private label strategy.

Gross margin was negative $1.4 million (-211%) for the fourth quarter of 2003, compared to $2.8 million (53%) for the same period in 2002. The decrease was the result of lower MEG and BpTRU sales against certain fixed manufacturing costs, and a charge to cost of revenue relating to the write-down of approximately $600,000 in BpTRU inventory due to slower than expected sales activity. Although initiatives were taken to improve margins through early stage implementation of some lean manufacturing principles, investment in capital equipment to increase throughput, and by "batching" production of standardized components into more economic quantities, these improvements were not sufficient to offset the negative impact on gross margin of lower revenues against our fixed plant costs.

Expenses

Research and product development expenses increased to $1.7 million for the fourth quarter of 2003, compared to $714,000 for the same period in 2002. The increase is due to continued investment in R&D efforts directed at the Company's proprietary technologies in the MEG and blood pressure fields. Specific areas of increase occurred in headcount, salaries and research grants. In particular, a grant for approximately $460,000 was made to the University of California in San Francisco for the research of MEG applications. The Company also recorded approximately $210,000 in R&D for MEG inventory used specifically for research and product development purposes.

Sales and marketing expenses increased to $967,000 for the fourth quarter of 2003, compared to $691,000 for the same period in 2002. The increase in marketing expenditures is due largely to the Company's efforts to increase MEG product awareness in the U.S. marketplace. The Company had two senior sales staff in place during the fourth quarter of 2003 whereas only the first U.S. MEG sales staff was hired in the fourth quarter of 2002. Other costs such as tradeshows and travel also increased due to the focus on penetrating the U.S. MEG market.

General and administrative expenses increased to approximately $1.4 million for the fourth quarter of 2003, compared to $772,000 for the same period in 2002. The primary areas of increase are corporate governance costs, additional headcount, salaries, legal and accounting fees, corporate communications costs, and insurance premiums.

Amortization expense increased to $245,000 for the fourth quarter of 2003, compared to $151,000 for the same period in 2002 as a result of amortization relating to equipment acquired in 2003.

Net loss

The consolidated net loss for the fourth quarter of 2003 was $5.9 million ($0.14 per share), compared to net earnings of $446,000 ($0.02 per share) for the fourth quarter of 2002.

Proposed transactions

The Company is not aware of any material proposed transactions requiring disclosure.

Critical accounting policies and estimates

The Company has been generating revenue through two sources: 1) the sale of medical devices ("BpTRU") and MEG products and 2) the custom manufacture of MEG systems under long-term contracts. During the fourth quarter of 2003, the Company raised additional financial resources, initiated improved production methods and commenced manufacturing standard MEG subassemblies and products to inventory. Such MEG products are sold to customers under standardized product sales arrangements. The Company also sells blood pressure monitors. Revenue from the sale of standard MEG products and blood pressure monitors is recognized upon delivery to the customer, if persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. The adoption of product revenue recognition for standardized MEG products has been applied to product sales beginning in the fourth quarter of 2003.

Where the Company enters into long-term contracts for the custom manufacture of MEG systems and for MEG system contracts in place prior to the fourth quarter of 2003, the Company accounts for such contracts based on their contract provisions. Where persuasive evidence of an arrangement exists, collection is probable, the contract price is fixed or determinable and customer acceptance is based on controllable performance criteria, the Company recognizes such arrangements using the percentage of completion basis. Management determines the stage of completion based on the percentage of actual costs incurred to date of the total expected costs on a contract-by-contract basis. Any expected loss on a contract is recognized immediately. Contract amendments or changes to estimated total expected costs can have a material impact on the amount of revenue recognized in each reporting period. In addition, estimates are made to establish if a contract is profitable to determine if any losses on contracts need to be recorded. The revenue impact of contract amendments or changes in estimate is recognized in the financial statements immediately.

The Company expects that the majority of future MEG revenue will be derived from standardized product sales rather than from custom manufacture. As a result, the Company expects its future revenues to reflect this change and be recognized on a more sporadic or "lumpy" basis, as the Company will not recognize revenue until the criteria for recognition (including delivery) have occurred. In addition, the standardization of product manufacture will result in increased inventory and work in progress, recorded at the costs of production, both attributable to the Company's MEG operations.

Often, the Company's sales of MEG systems include installation, training and maintenance services. Installation and training are typically completed prior to acceptance and are recorded as services are rendered. Revenue from maintenance services is treated as a separable earnings process, based on its fair value when sold separably, and is recognized ratably over the service period. The allocation of revenue under such bundled arrangements may involve the use of estimates and therefore affects the timing of revenue recognized.

Changes in accounting policies including initial adoption

The Canadian Institute of Chartered Accountants ("CICA") has adopted several new standards, including the following pronouncements, which will become effective for future periods.

CICA Handbook ("HB") Section 3062 "Impairment of Long-Lived Assets" addresses the recognition, measurement and disclosure of the impairment of long-lived assets by profit-orientated enterprises. The standard is effective for fiscal years beginning on or after April 1, 2003. Although the Company has not completed its evaluation of the implications of this standard, Section 3063 is not expected to have a material impact on the Company's financial position or results of operations.

In addition, CICA HB Section 3475 "Disposal of Long-Lived Assets and Discontinued Operations" addresses recognition, measurement, presentation and disclosure of the disposal of long-lived assets, as well as presentation and disclosure of discontinued operations for profit-orientated enterprises and not-for-profit organizations. The standard is applicable to disposal activities initiated by an enterprise's commitment to a plan on or May 1, 2003. The application of Section 3475 did not have an impact on the Company's financial position or results of operations.

In 2003, the CICA amended HB Section 3870 "Stock-Based Compensation and Other Stock Based Payments" to require recognition of stock-based compensation expenses in the income statement for employee stock-based compensation transactions. This eliminates the previous option that the Company had to only disclose the effect on net loss and net loss per share on a pro forma basis in the notes to the financial statements. The provisions provide for various possible transition alternatives, permitting either retroactive (with or without restatement) or prospective application of the recognition provisions to awards previously accounted for at fair value. Prospective application is only available to enterprises that elect to apply the fair value based method of accounting for fiscal years beginning before January 1, 2004. The Company has elected to adopt Section 3870 effective January 1, 2004 on a retroactive basis. The impact on the 2002 and 2003 financial statements upon adoption is reflected in the pro forma stock-based compensation disclosures currently included in the notes to the financial statements.

Financial instruments and other instruments

The Company is exposed to exchange rate risk through its transactions in U.S. dollars, Euros and other currencies in which the Company enters into contracts. To date, the Company has not entered into any foreign exchange forward contracts.

The Company does not expect to enter into any foreign exchange forward contracts, however, consideration will be given to entering into such contracts should the Company consider it necessary in order to reduce the exposure of foreign exchange fluctuations.

The Company is exposed to credit risk as a substantial portion of its annual revenue is generated from a small number of purchasers of its MEG products and custom product systems. Failure of the Company to recover the contract price from one or more of those purchasers may have a significant negative financial effect on the Company. The Company manages its credit risk by closely monitoring the granting of credit. MEG systems sales terms include cash payment upfront, upon milestones, and upon delivery and acceptance. The Company's credit process includes credit reviews and the use of export sales insurance.

With respect to the fair value of the Company's financial instruments, the carrying values of cash and cash equivalents, short-term investments, accounts receivable, restricted cash, accounts payable and accrued liabilities, loans payable, and obligations under capital lease as reflected on the balance sheet approximate their respective fair values as at December 31, 2003 and 2002.

Risks and uncertainties

To the extent possible, management implements strategies to reduce or mitigate the risks and uncertainties associated with the Company's business. Operating risks include (i) market acceptance of the Company's technology and products, (ii) the Company's ability to obtain and enforce timely patent protection of its technology and products, (iii) the competitive environment and impact of technological change, and (iv) the continued availability of capital to finance the Company's activities.

Subsequent events

On January 9, 2004, the Company announced a number of senior management changes and the formation of a new Customer Services business unit. As a result of these changes in organizational structure and as the Company prepares to consolidate its activities into a new, more efficient manufacturing facility, the Company has implemented a reduction of approximately 10 percent of its workforce from all levels of the Company. The total restructuring charge will be an estimated $496,000 consisting of severance and related costs. The charge will be taken entirely within the Company's first quarter ending March 31, 2004.

On February 27, 2004, the former chief executive officer ("CEO") of the Company resigned, which resulted in the provision of a severance package. Upon the resignation, the Company paid to the former CEO the gross salary attributed to the remaining term of his employment agreement up to May 31, 2005 in the amount of $406,250, and a lump-sum payment owing under an incentive bonus plan in the amount of $99,500.

Outlook

Near-term, management believes the majority of its MEG sales will continue to be to institutionally based customers such as clinical research centers and universities. Given the increasing recognition of the clinical utility of MEG and the recent increases in reimbursement rates for clinical MEG applications in the United States, management believes that sales to clinically focused sites such as institutional clients utilizing MEG systems for non-research applications and, in the future, private purchasers operating MEG systems in for-profit clinical applications, will increase. Any such shift toward clinically oriented sales will likely be associated with shorter sales cycles and shorter time-to-delivery requirements and will require a more standardized product.

Management believes that the Company is well positioned to maintain its technology leadership and market leading position in production and delivery of MEG systems. Based on the current level of sales activity, VSM anticipates receiving between eight and ten new MEG orders in 2004, an improvement over the five orders received in 2003. The Company's objective is to ship eight systems in 2004, compared with the three MEG systems shipped in 2003. The Company's revenue in 2004 will be impacted by the adoption of a new revenue recognition policy. The revenue for five systems expected to be shipped in 2004 is recognized using the percentage of completion basis and as a result the revenue was principally recognized in prior fiscal years. Revenue on standardized product sales will be recognized in 2004 upon delivery and acceptance by the customer, amongst other factors.

Other

Outstanding share data

As at April 30, 2004, the Company had 42,940,727 common voting shares issued and outstanding.

Additional information

Additional information relating to the Company, including a copy of the Company's Annual Information Form, is available at www.sedar.com.

management's responsibilities for financial reporting

The management of VSM MedTech Ltd. is responsible for the preparation of the accompanying consolidated financial statements and the preparation and presentation of information in the Annual Report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position and operating results of the Company.

The Company maintains various systems of internal control to provide reasonable assurance that transactions are appropriately authorized and recorded, that assets are safeguarded and that financial reports are properly maintained to provide accurate and reliable financial statements.

The Company's audit committee is comprised of three non-management directors and is appointed by the Board of Directors annually. The committee meets periodically with the Company's management and independent auditors to review the consolidated financial statements and the independent auditors' report. The audit committee reported its findings to the Board of Directors who have approved the consolidated financial statements.

The Company's independent auditors, Deloitte and Touche LLP, have examined the consolidated financial statements and their report follows.

Jack Price
President and Chief Executive Officer
February 27, 2004

Rod Campbell
Chief Financial Officer

auditors' report

To the Shareholders of **VSM MedTech Ltd.**

We have audited the consolidated balance sheets of VSM MedTech Ltd. as at December 31, 2003 and 2002 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP
Chartered Accountants
Vancouver, British Columbia
February 27, 2004

consolidated balance sheet

Years ended December 31, 2003 and 2002

	2003	2002
ASSETS		
CURRENT		
Cash and cash equivalents	$ 30,047,515	$ 1,799,105
Accounts receivable	726,538	1,316,570
Contracts in progress	10,094,840	9,471,543
Inventory *(Note 3)*	7,231,868	2,336,295
Prepaid expenses	361,460	128,461
	48,462,221	15,051,974
PROPERTY, PLANT AND EQUIPMENT *(Note 4)*	3,029,578	871,254
INTANGIBLE AND OTHER ASSETS *(Note 5)*	851,843	588,618
GOODWILL *(Note 5)*	709,691	709,691
	$ 53,053,333	$ 17,221,537
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	$ 3,990,807	$ 2,624,570
Deferred revenue and customer advances *(Note 6)*	4,269,750	3,787,271
Current portion of loans payable *(Note 7)*	226,104	400,000
	8,486,661	6,811,841
Loans payable *(Note 7)*	339,153	–
	8,825,814	6,811,841
CONTINGENCIES AND COMMITMENTS *(Notes 4 and 8)*		
SHAREHOLDERS' EQUITY		
Share capital *(Note 9)*	67,657,056	23,498,879
Contributed surplus and other equity *(Note 9)*	446,121	423,217
Deficit	(23,875,658)	(13,512,400)
	44,227,519	10,409,696
	$ 53,053,333	$ 17,221,537

APPROVED BY THE DIRECTORS

Director
David Waterman

Director
Jack Price

consolidated statements of operations and deficit

Years ended December 31, 2003 and 2002

	2003	2002
REVENUE	$ 11,377,917	$ 14,203,346
COSTS OF REVENUE	7,890,514	7,429,941
	3,487,403	6,773,405
EXPENSES		
Research and product development	3,752,861	2,642,258
Sales and marketing	3,118,486	2,399,396
General and administrative	3,684,055	2,588,094
Interest and financing, net	171,774	101,597
Loss on contracts (Note 10)	2,517,823	-
	13,244,999	7,731,345
Loss before amortization	(9,757,596)	(957,940)
Amortization	605,662	347,653
Net loss	(10,363,258)	(1,305,593)
DEFICIT, BEGINNING OF YEAR	(13,512,400)	(12,206,807)
DEFICIT, END OF YEAR	$ (23,875,658)	$ (13,512,400)
LOSS PER SHARE		
Basic and diluted	$ (0.28)	$ (0.05)
WEIGHTED-AVERAGE NUMBER OF COMMON SHARES		
Basic and diluted	36,376,131	26,975,051

consolidated statements of cash flows

Years ended December 31, 2003 and 2002

	2003	2002
OPERATING ACTIVITIES		
Net loss	$ (10,363,258)	$ (1,305,593)
Adjustments for items not involving cash:		
Amortization of property, plant and equipment	433,113	248,985
Amortization of intangible and other assets	172,549	98,668
Loss on contracts	2,517,823	–
Non-cash gain on disposal of other asset	(14,295)	–
Non-cash stock-based consulting expense	52,253	–
Changes in non-cash operating assets and liabilities		
Increase in accounts receivable	(184,826)	(778,233)
Increase in contracts in progress	(3,474,170)	(2,681,964)
Increase in inventory	(3,924,887)	(1,111,768)
Increase in prepaid expenses	(173,833)	(29,443)
Increase in accounts payable and accrued liabilities	1,059,558	465,548
Increase in deferred revenue	482,479	102,072
	(13,417,494)	(4,991,728)
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(2,218,667)	(452,419)
Purchase of intangible and other assets	(206,772)	(145,335)
	(2,425,439)	(597,754)
FINANCING ACTIVITIES		
Loan advances (repayments), net	165,257	(433,952)
Proceeds on issuance of common shares	43,950,972	5,523,411
Repayment of obligations under capital lease	(24,886)	(23,566)
	44,091,343	5,065,893
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	28,248,410	(523,589)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,799,105	2,322,694
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 30,047,515	$ 1,799,105

SUPPLEMENTAL CASH FLOW AND NON-CASH INVESTING AND FINANCING DISCLOSURES *(Note 11)*

1. Nature of business

VSM MedTech Ltd. (the "Company") specializes in the design and development of medical devices. The Company's growing family of devices enhance patient outcomes by improving the diagnosis and measurement of human physiological conditions. The Company's proprietary, non-invasive solutions include applications for the accurate measurement of blood pressure and diagnosis of hypertension in both primary and acute-care health care environments, and imaging systems for the assessment of adult and fetal brain function.

2. Significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting policies:

(a) Basis of presentation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

(b) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the year. Significant estimates are used for but not limited to the determination of the allowance for doubtful accounts, allocation of direct overhead costs to inventory, assessment of the stage of completion of contracts in progress, assessment of the recoverability of long-lived assets, fair value of unbundled elements in multiple element sales arrangements, amortization, taxes and contingencies. Actual results could differ from those estimates.

(c) Foreign currency translation

The functional currency of the Company is the Canadian dollar. Monetary assets and liabilities denominated in currencies other than the Canadian dollar are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at the exchange rates in effect at the time of the transactions. Revenues and expenses denominated in foreign currencies are translated at rates approximating the exchange rates in effect at the time of the transactions. Gains or losses on translation are included in operations.

(d) Cash and cash equivalents

Cash and cash equivalents includes cash and short-term money market instruments which, at the time of acquisition, have a term to maturity of three months or less.

(e) Inventory

Inventory includes all raw materials, work in progress and finished goods of standard MEG and BPM products. Raw materials are reported at the lower of cost and estimated net realizable value. Work in progress is reported at the lower of laid in cost (direct materials, labour and direct production overheads) and net realizable value. Finished goods are reported at the lower of cost and net realizable value less normal profit margin.

(f) Property, plant and equipment

Property, plant and equipment are recorded at cost which is amortized over estimated useful lives as follows:

Furniture and fixtures	20% per year on a declining balance basis
Computer equipment	30% per year on a declining balance basis
Plant and laboratory equipment	20% per year on a declining balance basis
Leasehold improvements	Straight line over the term of the lease

The Company does not amortize construction in progress until the asset is placed into productive use.

The Company reviews for the impairment of property, plant and equipment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable from expected future cash flows.

(g) Goodwill and intangibles

As of January 1, 2002, the Company adopted the standard in Section 3062, Goodwill and Other Intangible Assets, of the Canadian Institute of Chartered Accountant ("CICA") Handbook to be applied prospectively. Under the new standard, goodwill is no longer amortized but tested for impairment on an annual basis and the excess of the carrying value amount over the fair value of goodwill is charged to earnings. Other intangibles include patent related costs, licenses and trademarks which are amortized on a straight-line basis over a period of one to five years. Under the new standard, in 2002, the Company completed its transitional assessment of impairment and identification of separable intangibles. No amount of goodwill was determined to be impaired.

(h) Other assets

Other assets include restricted cash and deferred financing fees. The Company amortizes direct costs of financing debt on a straight line basis over the lesser of the initial term to renewal and term to maturity, being four years.

(i) Revenue recognition

The Company has been generating revenue through various sources: (1) the sale of medical devices and magnetoencephalography ("MEG") products; and (2) the custom manufacture of MEG systems under long-term contracts.

(i) Product sales

During the fourth quarter of 2003, the Company raised additional financial resources, initiated improved production methods and commenced manufacturing standard MEG subassemblies and products to inventory. Such MEG products are sold to customers under standardized product sales arrangements. The Company also sells blood pressure monitors. Revenue from the sale of standard MEG products and blood pressure monitors is recognized upon delivery and acceptance by the customer, if persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. The adoption of product revenue recognition for standardized MEG products has been applied to product sales beginning in the fourth quarter of 2003.

The Company's product sales arrangements may require customer payments in advance of delivery. These amounts are reflected as customer advances and recognized as revenue based on the underlying arrangement.

(ii) Contract sales

Where the Company enters into long-term contracts for the custom manufacture of MEG systems and where MEG system contracts were in place prior to the fourth quarter of 2003, the Company accounts for such contracts based on their contract provisions. Where persuasive evidence of an arrangement exists, collection is probable, the contract price is fixed or determinable and customer acceptance is based on controllable performance criteria, the Company recognizes such arrangements using the percentage of completion basis. Management determines the stage of completion based on the percentage of actual costs incurred to date of the total expected costs on a contract by contract basis. Any expected loss on a contract is recognized immediately.

The Company's custom manufacturing sales arrangements may require customer payments in advance of delivery. These amounts are reflected as customer advances and recognized as revenue based on the underlying arrangement.

For contracts where significant customization or high technical uncertainty exists, the contracts will be accounted for under the completed contract method of accounting for long-term contracts.

(iii) Bundled sales

The Company accounts for certain bundled sales (MEG products or systems, installations, training and maintenance) as multiple-element arrangements. The Company recognizes revenue for these elements separately as (1) the sales of the MEG products or systems, installation, training and maintenance represent separate earnings processes; (2) revenue is allocated among the elements based on evidence of the fair value of the elements; and (3) where installation and associated training are completed prior to acceptance of the MEG product or systems.

(iv) Installation, training and maintenance

Where installation and training are determined to be separable elements of sales arrangements, revenues from such services are recognized as such services are performed. Where installation and training are not separable components of such sales, revenue from such services are recognized based on the underlying arrangement. Equipment maintenance service and extended warranty contracts for MEG products and custom systems and associated revenues will be recognized ratably over the respective maintenance period.

(v) Contracts in progress and deferred revenue

Contracts in progress includes direct materials and labour, and estimated gross profit determined on a percentage of completion basis for custom MEG systems and contracts in place at October 1, 2003, and is reported at the lower of the calculated amount and estimated net realizable value.

Deferred revenue represents cash received for product sales or custom manufacturing, installation, training or maintenance revenue, which has not yet met the Company's revenue recognition criteria.

(j) Research and product development costs

Research and product development costs include costs for clinical trials, product enhancements, research grants through collaborative arrangements and ongoing research. Research costs are expensed when incurred. Product development costs are capitalized to the extent that recovery of these costs is assured, and are amortized over the life of the related product. No development costs have been capitalized as at December 31, 2003.

(k) Income taxes

Future income taxes relate to the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. Future tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

(l) Stock-based compensation

The Company accounts for all stock-based awards made to non employees using the fair value based method. The CICA Handbook encourages the use of a fair value based method for all awards granted on or after January 1, 2002 to employees, but only requires the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets. Awards that a company has the ability to settle in stock are recorded as equity, whereas awards that the entity is required to or has a practice of settling in cash are recorded as liabilities. The Company has adopted the disclosure only approach for stock-based awards to employees and directors rather than the fair value method.

The Company has a stock-based compensation plan. Under the plan, options are granted with an exercise price equal to the fair value of the Company's stock at the time of grant. No compensation expense has been recognized for options granted under the plan when stock options are issued to employees and directors. Any consideration paid by employees and directors on exercise of stock options is credited to share capital.

(m) Loss per common share

Loss per share is calculated based on the weighted average number of shares outstanding during the year. Basic loss per share has been computed by dividing the loss available to common shareholders by the weighted average number of common shares outstanding during the respective years. Diluted loss per share calculations assume exercise of options and warrants by applying the treasury stock method, if dilutive, effective on their dates of issue.

(n) Comparative figures

Certain of the prior year's figures have been reclassified to conform with current year's presentation.

3. Inventory

	2003	2002
Raw materials	$ 5,342,807	$ 1,729,717
Standard MEG work in progress	1,143,105	-
BPM work in progress	164,392	335,117
BPM finished goods	581,564	271,461
	$ 7,231,868	$ 2,336,295

4. Property, plant and equipment

			2003	2002
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Furniture and fixtures	$ 287,767	$ 94,216	$ 193,551	$ 130,657
Computer equipment	316,314	112,029	204,285	62,528
Plant and laboratory equipment	1,453,503	342,014	1,111,489	433,848
Leasehold improvements	617,257	327,279	289,978	244,221
Construction in progress	1,230,275	–	1,230,275	–
	$ 3,905,116	$ 875,538	$ 3,029,578	$ 871,254

The net book value of assets under capital lease at December 31, 2003 totalled $41,281 (December 31, 2002 - $51,602), net of accumulated amortization of $30,389 (December 31, 2002 - $20,068).

Construction in progress relates to the purchase and construction of equipment for the Company's new SQUID manufacturing facility. Construction is expected to be completed in the first half of fiscal 2004 with an expected total cost of $4 million. The Company will commence amortization when the asset has completed testing and is placed into productive use. No interest expense has been capitalized as part of the cost of construction.

5. Goodwill, intangible and other assets

	Cost	Accumulated Amortization	2003 Net Book Value	2002 Net Book Value
Goodwill	$ 1,021,955	$ 312,264	$ 709,691	$ 709,691
Intangible and other assets				
Patent costs	488,894	224,624	264,270	298,767
Deferred financing fees	384,290	84,815	299,475	81,757
Trademark and licenses	106,460	9,548	96,912	–
	979,644	318,987	660,657	380,524
Restricted cash	191,186	–	191,186	208,094
	$ 1,170,830	$ 318,987	$ 851,843	$ 588,618

The Company holds restricted cash as security to satisfy certain commitments with customers, lessors and suppliers.

6. Deferred revenue and customer advances

	2003	2002
Advances received on contracts in progress	$ 2,576,738	$ 3,282,422
Advances received on inventory	1,139,600	-
Deferred revenue	553,412	504,849
	$ 4,269,750	$ 3,787,271

Under the terms of sales arrangements, certain customer advances are secured by standby letters of credit and the underlying contracts in progress or inventory.

7. Loans payable

		2003	2002
(a)	$3 million term loan with a U.S. bank, maturing in May 2006, bearing interest at prime plus 2%. Loan is repayable in thirty equal monthly installments of principal plus accrued interest, beginning in January 2004. The credit facility is secured by all assets of the Company, excluding certain intellectual property.	$ 565,257	$ –
(b)	$3 million (increased from $2 million in 2002) working capital credit facility with a U.S. bank, maturing in May 2004, bearing interest at Bank prime plus 3%. The credit facility is secured by all assets of the Company, excluding certain intellectual property.	–	400,000
		565,257	400,000
	Less: Current portion	226,104	400,000
		$ 339,153	$ –

Principal repayments on loans payable in each of the next three years are as follows: 2004 - $226,104; 2005 - $226,104; and 2006 - $113,049.

8. Commitments

Capital and operating leases

Minimum future payments under capital leases and non-cancellable operating leases for computer equipment, furniture and fixtures (secured by the underlying leased assets), manufacturing facilities and office space are as follows:

	Operating leases	Capital leases
2004	$ 746,828	$ 6,585
2005	999,195	–
2006	944,360	–
2007	868,075	–
2008	856,334	–
Thereafter	4,621,162	–
Total minimum lease payments	$ 9,035,954	$ 6,585
Less: Amounts representing imputed interest at 7%		(71)
Present value of net current and future minimum lease payments		$ 6,514

The Company entered into an agreement to lease new research, manufacturing and office premises in a 76,000 square foot building with occupancy set for the first quarter of 2004. The lease term is for a minimum of 10 years from the occupancy date and the gross annual rent is expected to be approximately $850,000 for the first five years and $890,000 for the subsequent five years. As part of this agreement, the Company has provided to the landlord a standby letter of credit for $750,000. No collateral is required for the letter of credit, however, the Company's $3 million available operating line is reduced by $750,000.

Capital lease obligations of $6,514 (2002 - $31,490) are classified in accounts payable and accrued liabilities

Research collaboration and license agreements

The Company has entered into research collaboration and license agreements with certain customers on programs directed at either research activities that will increase the future clinical applications for MEG or curriculum development that will build the necessary education infrastructure to train MEG technicians.

Minimum payments under the research collaboration agreements over the next four years are as follows:

	Research commitments
2004	$ –
2005	262,800
2006	262,800
2007	262,800
Total minimum research collaboration	$ 788,400

In addition to the research collaboration agreements, the Company entered into an exclusive license agreement for the use of technology necessary for the development of a hybrid MEG/MRI system. The agreement allows termination upon 90 days' written notice. Under the terms of the agreement, the Company has made an initial payment of U.S.$50,000 and is required to pay a royalty based on sales of the hybrid system. The agreement sets forth minimum annual royalties of U.S.$10,000 for the first two years and escalates to a royalty cap of U.S.$500,000 in 2009 and each year thereafter.

9. Share capital, contributed surplus and other equity

(a) Authorized

Unlimited number of common voting shares

(b) Issued

	2003		2002	
	Number of Shares	**Amount**	Number of Shares	Amount
Balance, beginning of year	**29,826,668**	**$23,498,879**	23,917,018	$ 16,797,468
Issued on:				
Private placement, net of issue costs of $752,195 (2002 - $638,314)	**5,800,000**	**9,977,805**	4,800,000	5,361,686
Public offering, net of issue costs of $2,469,415	**5,405,000**	**32,663,085**	–	–
Exercise of options	**506,375**	**623,555**	138,750	126,100
Exercise of warrants for cash	**358,079**	**621,846**	970,900	1,213,625
Exercise of warrants issued per financing fees	**160,806**	**271,886**	–	–
Balance, end of year	**42,056,928**	**$ 67,657,056**	29,826,668	$23,498,879

During October 2003, the Company completed a public offering of 5,405,000 common shares at a price of $6.50 per share, for gross proceeds of $35,132,500. An agents' commission was paid in cash equal to 6% of the gross proceeds, and 270,250 agents' warrants were issued entitling the agents to purchase 270,250 common shares at a price of $6.71 per common share for a period of two years.

During February 2003, the Company completed an issuance of common shares by way of a private placement through a syndicate of five agents. The Company issued 5,800,000 units at a price of $1.85 per unit for total gross proceeds of $10,700,000. Each unit consists of one common share and one-quarter (1/4) of a common share purchase warrant. Each whole purchase warrant entitles the holder to acquire one common share, exercisable until the date that is two years from closing at a price of $2.00 per share. An agents' commission was paid in cash equal to 6% of the gross proceeds, and 206,667 agent's warrants were issued entitling the agents to purchase 206,667 common shares at a price of $1.90 per common share for a period of two years.

During May 2002, the Company completed a private placement of 4,800,000 common shares at a price of $1.25 per share, for gross proceeds of $6,000,000. An agents' commission was paid in cash equal to 7% of the gross proceeds, and 336,000 agent's warrants were issued entitling the agents to purchase 336,000 common shares at a price of $1.44 per common share for a period of two years.

(c) Stock options and stock-based compensation

(i) The Company has granted incentive stock options to certain directors, consultants and employees entitling them to acquire common shares of the Company. The options may be exercisable for a period of up to 5 years and vest over a period of 1 to 4 years. A summary of option activity during the 2003 and 2002 years is presented below:

	2003		2002	
	Number of Shares	**Weighted Average Exercise Price**	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	**2,789,500**	**$ 1.14**	2,321,500	$ 1.10
Granted	**225,000**	**4.11**	829,500	1.36
Exercised	**(506,375)**	**1.17**	(138,750)	0.91
Forfeited/cancelled	**(7,500)**	**1.29**	(222,750)	1.63
Outstanding, end of year	**2,500,625**	**$ 1.40**	2,789,500	$ 1.14

The following table summarizes information about stock options outstanding and exercisable under the Company's stock option plan at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.45 - $0.65	415,000	0.4 years	$ 0.46	415,000	$ 0.46
$0.66 - $1.00	221,000	2.6 years	0.96	221,000	0.96
$1.01 - $1.50	1,519,250	2.3 years	1.31	1,250,917	1.31
$1.51 - $2.00	220,375	2.6 years	1.71	147,458	1.63
$2.01 - $6.34	125,000	4.7 years	5.86	5,208	3.96
	2,500,625		$ 1.40	2,039,583	$ 1.13

As at December 31, 2003, the Company was eligible to issue options, in addition to the outstanding options identified above, to acquire up to 585,077 (2002 - 10,077) shares of the Company.

(ii) When stock-based compensation awards are granted to employees, no compensation expense is recognized when their exercise price exceeds or equals the fair value of the Company's common shares at the date of grant. Accordingly, no compensation expense has been recognized for each of the years ended December 31, 2003 and 2002. Had compensation expense for the Company's stock-based compensation plan been determined based on the fair value based method of accounting for all awards granted since January 1, 2002, the Company's net loss and loss per share would have been increased to the pro forma amounts indicated below:

	2003	2002
Net loss for the year		
As reported	$ 10,363,258	$ 1,305,593
Additional stock compensation expense under the fair value based method	412,286	214,086
Pro forma	$ 10,775,544	$ 1,519,679
Loss per common share, basic and diluted		
As reported	$ 0.28	$ 0.05
Pro forma	$ 0.30	$ 0.06

The pro forma amounts may not be representative of future disclosures since the estimated fair value of stock options is amortized over the vesting period and additional options may be granted in future years.

The weighted average fair value of stock options granted in 2003 was $4.79 per option. The Company used the Black-Scholes option-pricing model to estimate the value of the options at each grant date, using the following weighted average assumptions:

	2003	2002
Dividend yield	None	None
Annual volatility	112.0%	107.9%
Risk-free interest rate	4.05%	4.20%
Expected life	4 years	4 years

(d) Warrants

Warrants issued by the Company at December 31, 2003, and activity during the 2003 and 2002 years are summarized as follows:

	Number of Warrants	Exercise Price	Expiry Date
Balance, December 31, 2001	3,874,066	$0.62 to $1.75	January 28, 2002 to March 31, 2004
Issued	391,172	$1.44 to $1.45	May 28, 2004 to October 23, 2007
Exercised	(970,900)	$1.25	December 31, 2002
Expired	(2,861,500)	$1.50 to $1.75	January 28, 2002 to September 18, 2002
Balance, December 31, 2002	432,838	$0.82 to $1.45	March 31, 2004 to October 23, 2007
Issued	2,128,175	$1.59 to $6.71	February 19, 2005 to May 16, 2008
Exercised	(518,885)	$1.44 to $2.00	May 28, 2004 to May 16, 2008
Expired/cancelled	(95,624)	$1.50 to $1.75	October 23, 2007 to May 16, 2008
Balance, December 31, 2003	1,946,504	$1.02 to $6.71	March 31, 2004 to October 8, 2005

During May 2003, the Company entered into an agreement with a U.S. bank that provides for borrowing of up to $6,000,000 (see Note 7). In connection with the agreement, the Company issued warrants with a fair value of $271,886 to purchase 201,258 common shares for $1.59 per share expiring in 5 years. The costs associated with the issuance of the warrants have been accounted for as a deferred financing fee. The Company has cancelled previously issued warrants to this U.S. bank in 2002 (see below).

During 2002, the Company entered into an agreement with a U.S. bank that provides for borrowing of up to $2,000,000 (see Note 7 (b)). In connection with the agreement, the Company issued warrants with a fair value of $57,178 to purchase 55,172 common shares for $1.45 per share expiring in 5 years. The costs associated with the issuance of the warrants were accounted for as deferred financing fees (Note 5) until their cancellation in 2003 (see above).

(e) Contributed surplus and other equity

Contributed surplus and other equity at December 31, 2003, and activity during the 2003 and 2002 years, are summarized as follows:

	2003	2002
Balance, beginning of year	$ 423,217	$ 1,544,039
Warrants issued for financing fee	271,886	57,178
Options issued for consulting expense	111,419	–
Warrants exercised	(271,886)	(1,178,000)
Options exercised	(31,337)	–
Warrants cancelled	(57,178)	–
Balance, end of year	$ 446,121	$ 423,217

In 2003, the Company granted incentive 100,000 stock options that were specifically approved at the Company's 2003 Annual General Meeting to an external consultant for the provision of corporate communication services. The options have a strike price of $1.91, are exercisable for 5 years and vest over a two year period. The options have a fair value of $111,419 and are being charged to operations over the two year vesting period.

Warrants issued in May 2003 to a U.S. bank (see Note 9 (d)) were fully exercised during the year. As permitted under the terms of the warrant agreement, the U.S. bank exercised all of the warrants based on a non-cash formula. In lieu of paying the full cash subscription price for the 201,258 warrants granted at $1.59, the U.S. bank received 160,806 common shares in full satisfaction of the warrants. The remaining 40,452 warrants were cancelled.

10. Loss on contracts

During the year, the Company became concerned with two customers' ability to complete arrangements under contracted terms. As a result, the Company has recorded a provision for a loss on completion related to three MEG systems.

Under one contract, the Company had recognized revenue and costs of sales on two MEG systems in the second quarter of 2003. The Company has provided for a loss on the contract of $1.6 million.

Under the second contract, the Company commenced recognition of revenue and costs of sales on one MEG system in the fourth quarter of 2002. The Company has provided for a loss on the contact of $0.9 million.

11. Supplemental cash flow and non-cash investing and financing disclosures

(a) Cash paid in respect to interest and income taxes were as follows:

	2003	2002
Interest paid	$ 29,019	$ 52,147
Income taxes paid	–	–

(b) Non-cash investing and financing disclosures:

	2003	2002
(i) Options issued for consulting services (Note 9 (e))	$ 111,419	$ –
(ii) Warrants issued for financing fee (Note 9 (d))	271,886	57,178
(iii) Warrants cancelled (Note 9 (d))	57,178	–
(iv) Unpaid investing and financing activities included in accounts payable and accrued liabilities:		
Property, plant and equipment	372,770	–
Share issuance costs	96,017	–

12. Income taxes

The reported income tax recovery differs from the amount computed by applying the Canadian basic statutory rates to the net loss. The reasons for this difference and the related tax effects are as follows:

	2003		2002	
Tax recovery at basic Canadian statutory rate	$ 3,691,392	35.62%	$ 491,164	37.62%
Effect of non-deductible expenses	(14,744)	(0.14%)	(18,022)	(1.38%)
Losses and other temporary differences producing no current tax benefit	(3,676,648)	(35.48%)	(473,142)	(36.24%)
	$ –	– %	$ –	–%

Future income taxes result principally from temporary differences in the recognition of certain revenue and expense items for financial and income tax reporting purposes. Significant components of the Company's future tax assets and liabilities are as follows:

	2003	2002
Future income tax assets		
Tax loss carry forwards	$ 9,510,540	$ 5,793,480
Book and tax base differences on assets	1,231,392	372,737
Non-refundable investment tax credits	45,752	318,138
Scientific research and experimental development deduction pool	35,620	601,920
Valuation allowance for future income tax assets	(8,579,244)	(4,791,455)
Net future income tax assets	2,244,060	2,294,820
Future income tax liabilities		
Contracts in progress	2,244,060	2,294,820
Net future income tax liabilities	$ –	$ –

Due to the uncertainty surrounding the realization of the future income tax assets in future income tax returns, the Company has a valuation allowance against certain of its future income tax assets.

At December 31, 2003, the Company has $26,700,000 (2002 - $15,400,000) of losses for tax purposes available at various dates until 2010, to be carried forward and applied against future income for tax purposes; $75,000 (2002 - $75,000) of investment tax credits available at various dates until December 31, 2011 to be carried forward and applied against future taxes payable; and $150,000 (2002 - $150,000) of unutilized scientific research and experimental development expenditures available to reduce future income for tax purposes.

13. Financial instruments and concentration of risk

(a) Fair value

The carrying values of cash and cash equivalents, short-term investments, accounts receivable, restricted cash, accounts payable and accrued liabilities, loans payable, and obligations under capital lease as reflected on the balance sheet approximate their respective fair values as at December 31, 2003 and 2002 unless otherwise noted.

(b) Foreign exchange risk

The Company is exposed to exchange rate risk through transacting in U.S. dollars and Euros, as well as other currencies in which the Company enters into manufacturing and service contracts. The Company does not use derivative instruments to reduce its exposure to foreign exchange risk.

(c) Credit risk

The Company is exposed to credit risk as a substantial portion of its annual revenue is generated from a small number of purchasers of its MEG products and custom product systems. Failure of the Company to recover the contract price from one or more of those purchasers may have a significant negative financial effect on the Company (Note 14 (c)). The Company manages its credit risk by closely monitoring the granting of credit. MEG systems sales terms include cash payment upfront, upon milestones, and upon delivery and acceptance. The Company's credit process includes credit reviews and the use of export sales insurance.

14. Segment reporting

(a) Operating segments

The Company's reportable operating segments are the assembly, sale, and related product development of portable blood pressure monitoring equipment ("BPM"), and the manufacture, sale, servicing, and related product development of magnetoencephalography systems and products ("MEG"). The segments are managed separately and require different technology and marketing strategies.

Operating results and financial position by segment for the 2003 and 2002 years are summarized as follows:

				2003
	MEG	**BPM**	**Corporate**	**Total**
Revenue	$ 10,773,159	$ 604,758	$ –	$ 11,377,917
Amortization of property, plant and equipment	369,682	63,431	–	433,113
Interest and financing, net	–	–	171,774	171,774
Loss on contracts	2,517,823	–	–	2,517,823
Net loss	(3,285,022)	(3,222,407)	(3,855,829)	(10,363,258)
Segment assets	20,079,366	2,926,452	30,047,515	53,053,333
Expenditures for segment property, plant and equipment	2,134,631	84,036	–	2,218,667

				2002
	MEG	BPM	Corporate	Total
Revenue	$ 12,760,946	$ 1,442,400	$ –	$ 14,203,346
Amortization of property, plant and equipment	192,440	56,545	–	248,985
Interest and financing, net	–	–	101,597	101,597
Net income (loss)	3,299,595	(1,915,497)	(2,689,691)	(1,305,593)
Segment assets	11,993,602	3,428,830	1,799,105	17,221,537
Expenditures for segment property, plant and equipment	312,111	140,308	–	452,419

(b) Geographic segments

The Company recognized revenue earned from customers in the following geographic regions:

	2003	2002
United States	$ 6,525,748	$ 5,810,718
China	2,285,755	3,752,492
Canada	1,997,321	3,785,687
Other countries	569,093	854,449
	$ 11,377,917	$ 14,203,346

All significant long-lived assets of the Company are located in Canada.

(c) Major customers

For the 2003 year, revenue recognized on each of four (2002 - four) MEG orders under manufacture by the Company exceeded 10% of total revenue. Total revenue recognized on those orders was $6,168,392 (2002 - $8,264,849)

15. Related party transactions

Related party transactions during 2003 have been recorded at the exchange amount agreed to by the parties, and include the following:

(a) The Company recorded interest income totalling $Nil (2002 - $1,202) with respect to loans to directors that were repaid in 2002.

(b) The Company paid fees for consulting services totalling $67,250 (2002 - $94,750 to one director) to a former director of the Company.

(c) Prior to the negotiation of a final management employment contract, the Company paid fees of $108,333 to a director of the Company, for consulting services.

16. Subsequent events

(a) On January 9, 2004, the Company announced a number of senior management changes and the formation of a new Customer Services business unit. As a result of these changes in organizational structure and as the Company prepares to consolidate its activities into a new, more efficient manufacturing facility, the Company implemented a reduction of approximately 10 percent of its workforce from all levels of the company. The total restructuring charge will be an estimated $496,000 consisting of severance and related costs. The charge will be taken entirely within the company's first quarter ended March 31, 2004.

(b) On February 27, 2004, the former chief executive officer ("CEO") of the Company resigned, which resulted in the provision of a severance package. Upon the resignation, the Company paid to the former CEO the gross salary attributed to the remaining term of his employment agreement up to May 31, 2005 in the amount of $406,250, and a lump-sum payment owing under an incentive bonus plan in the amount of $99,500. The former CEO also receives certain employee benefits and the ability to exercise his stock options up to the end of his original employment term.

Certain statements in this report may constitute forward-looking statements. Such forward looking statements involve risks, uncertainties and other factors which may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements.

corporate information

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David Christie, MBA
Chief Operating Officer
Jiri Vrba, M.Sc., Ph.D.
Chief Technical Officer
Brian Prejna
Vice President,
MEG Sales
Frank Iafrato
Vice President,
Vital Signs Monitoring Sales
Ryan Males, Ph.D.
Vice President,
Marketing & Communications
Paul Murdoch
Vice President,
Customer Services

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VSM MedTech is listed on the Toronto Stock Exchange under the symbol VSM.

Annual general meeting of shareholders

June 23, 2004 at 2:00 pm
Morris J. Wosk Centre for Dialogue
3rd Floor Executive Room
580 West Hastings Street
Vancouver, British Columbia

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